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E.O. 12958: N/A
TAGS: EFIN ECON ELAB ALOW AR
SUBJECT: Argentina Economic and Financial Weekly for
the week ending February 17, 2006

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Weekly Highlights
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- The peso was unchanged against the USD, closing again at 3.08 ARP/USD.
- Venezuela buys a further USD 308 million of Boden 2012 bonds.
- Limited negative impact of foot-and-mouth disease as the EU only bans Argentine beef exports frm the infected region.
- GOA reached price-restraint agreements with wholesale distributors.
- GOA announces changes in social plans.
- Telefonica agreed to suspend its ICSID arbitration claim against the GOA.
- Monthly economic activity index up 9.1 percent in ¶2005.
- Commentary of the Week: "Doubts and certainties about the Bilateral Agreement Signed with Brazil"

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MARKETS
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The peso was unchanged against the USD this week, closing again at 3.08 ARP/USD.
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¶1. The peso remained flat versus the USD this week, closing at 3.08 ARP/USD. Earlier in the week, the peso depreciated one cent to 3.09 ARP/USD after the Central Bank (BCRA) purchased USD 64 million in the FX market on February 14. Then the BCRA kept up its active intervention by purchasing a total of USD 247 million which was neutralize by increased exporters sales as well as inflows to purchase domestic bonds, allowing the peso to recover its lost cent and close the week at 3.08 ARP/USD -- unchanged from last Friday's close. The peso exchange rate has depreciated 1 percent since the beginning of year.

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ECONOMY / FINANCE
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Venezuela buys a further USD 308 million of the Boden
¶2012.
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¶2. On February 14, the GOA reopened the Boden 2012 and sold USD 308 million (face value) to Venezuela. This debt sale is the third purchase during 2006, bringing the 2006 accumulated amount to USD 929 million (face value) and USD 750 million effective value. In 2005, the GOV purchased USD 1.9 billion worth of GOA bonds (USD 1.6 billion effective value). The GOV is reportedly planning a new purchase of USD 250 million of GOA bonds by the end of February.

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Limited negative impact of foot-and-mouth disease as the EU only bans Argentine beef exporters from the infected region.
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¶3. On February 15, the European Union (EU) announced its decision to ban Argentine beef imports from only eight departments from the Province of Corrientes -- where an outbreak of foot-and-mouth disease was found last week. This decision will help to moderate the negative impact from the disease since the EU in one of the largest markets for Argentine beef exports. Meanwhile, Israel announced it will ban beef imports only from Corrientes, while Chile stopped all beef imports from Argentina. Many countries have not yet announced any decision. According to Secretary of Agriculture Miguel Campos, exports of beef are likely to fall by around 20 percent or USD 280 million in monetary terms as a result of the outbreak. However, Campos added that the losses are unlikely to be as large as initially feared, since many countries are limiting the export ban to the infected region, which represents a very small share of Argentine production.

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IADB to approve USD 500 million-loan to Argentina.
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¶4. Argentina's representative at the Inter-American Development Bank (IADB), Eugenio Daz Bonilla, stated February 13 that the IADB may approve the USD 500 million adjustment loan to Argentina during its February 22 meeting. The IADB board will discuss the loan approval after having received an assessment letter from the International Monetary Fund (IMF) complimenting Argentina's recovery but also pointing out pending reforms. If approved, this loan would be the first adjustment loan received by the GOA without the umbrella of an IMF program. Meanwhile, the World Bank (WB) maintains on hold loans to the GOA for USD 875 million.

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GOA reached price-restraint agreements with wholesale distributors.
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¶5. The GOA closed a new agreement with the country's leading wholesale distributors on February 14. These new price-restraint agreements aim to maintain prices on 300 basic goods unchanged for one year, but also are subject to a bi-monthly monitoring of any changes in the economic environment. The Ministry of Economy and President Kirchner announced that they expected to close a new agreement with the Buenos Aires Central Market next week, which is the main price maker for fruits and vegetables in the country. According to local media, the agreement will include a list of

prices of the most popular goods in order to stabilize prices for those goods. Reaching an agreement with the Central Market is key to the GOA's anti-inflation effort, since fruits and vegetables prices represent 3.7 percent of the Consumer Price Index.

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GOA studying increasing the minimum income tax threshold, as demanded by unions.
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¶6. On February 16, Deputy Agustin Rossi -- the head of the Peronist block -- stated that the executive branch can implement an increase of the minimum threshold for the income tax paid by employees by decree as foreseen in the 2006 Budget Law. Reportedly, the GOA will increase the minimum threshold by 20 percent as well as reduce the tax rate for the excess income above the threshold, beginning in April. According to analysts, this measure will have an annual fiscal cost of ARP 530 million. Unions have been demanding this measure for some time. However, Hugo Moyano -- the leader of the CGT union -- stated that unions will only accept a minimum threshold of ARP 3,000 per month for single employees and ARP 4,000 per month for married employees -- much higher levels than the GOA is proposing. Currently, the minimum threshold is ARP 1,835 per month for single employees and ARP 2,235 per month for married employees. Reportedly, the GOA is also considering increasing the minimum threshold for the wealth tax to ARP 200,000 from its current level of ARP 102,000.

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GOA announces changes in social plans.
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¶7. On February 13, the GOA announced a reform in social programs, by which recipients of the Head-of-Household Program can voluntarily choose to receive Training and Employment Insurance while they retrain to improve their skills to look for a job. The aim of the measure is to boost job creation by setting up Employment Offices that will serve as a link between employers and job seekers. Head-of-household recipients receive ARP 150 per month, while the Training and Employment Insurance Program will provide ARP 250 per month for a maximum of two years. The Ministry of Labor estimated that 500,000 individuals will subscribe for the new Training and Employment Insurance Program in 2006.

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GOA to amend the Labor Risk Law.
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¶8. On February 14, President Kirchner announced that the GOA will send to Congress a bill to amend the Labor Risk Law by next week. According to local media, the Senate will start debating the bill in early March - when Congress begins its ordinary sessions. Under the bill, workers who suffer work accidents will have to choose between obtaining compensation provided by insurance companies and presenting claims before civil courts to request greater compensation. Employers have long requested an amendment of the Labor Risk Law to prevent employees from seeking compensation from both sources. However, employers would have preferred legislation limiting employees to obtaining compensation from insurance companies instead of having the option of presenting claims against employers in civil courts.

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Telefonica agreed to suspend its claim against the GOA.
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¶9. The GOA and Telefonica signed a Letter of understanding February 14 in which the company agreed to suspend its claim against the GOA for USD 2.8 billion in the International Center for the Settlement of Investment Disputes (ICSID -- an independent tribunal associated with the World Bank). [ Note: Telefonica's claim before the ICSID is the largest the GOA faces.] In exchange for suspending its claim, Telefonica will be able to extend for one hour the period in which it charges the highest tariff and to increase by three times the rates on incoming international calls. These changes will provide an additional annual income of approximately USD 20 million for the company. The agreement, however, does not include any direct increase in tariffs. President of Telefonica in Argentina Mario Vazquez announced investments worth ARP 1 billion in Argentina during
¶2006. On February 16, Minister of Planing De Vido stated that the GOA expects to reach an agreement with Telecom (the other largest telephone company) at the beginning of March, following Telefonica's agreement.

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BCRA rolls over its maturities.
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¶10. The BCRA received bids of ARP 1.2 billion in its February 14 Lebac auction, above the ARP 893 million in Lebacs that came due during the week. This allowed the BCRA to roll over its maturities for the third time in several weeks, accepting bids for ARP 1 billion. The yield on the 63-day Lebac dropped from 7.0 percent to 6.98 percent. The yield on the 42-day Lebac and 140-day Lebac remained unchanged at 6.80 percent and 7.65 percent, respectively. Lebacs for other maturities were withdrawn due to lack of interest. As in the previous auction, investors concentrated more than 70 percent of their bids in Nobacs of more than 9 months. The BCRA accepted ARP 742 million of Nobacs (72 percent of the accepted amount in the auction). The yield on the nine month Nobac reached 3.13 percent, while the yield on the 434 and 679 day Nobac remained unchanged at 6.19 percent and 5.56 percent, respectively.

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Monthly economic activity index up 9.1 percent in
¶2005.
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¶11. The monthly economic activity index increased a strong 8.1 percent y-o-y in December, slightly below the BCRA market survey forecast of 8.3 percent. The index jumped an impressive 9.1 percent in 2005, above market consensus of 9 percent and after increasing 9 percent in 2004 and 8.3 percent in 2003. The increase in the index is mainly attributed to a 7 percent increase in industrial activity, pushed by the construction component as well as exports performance. The strong 2005 growth will provide a 4 percent carry-over effect for 2006. The BCRA consensus survey estimates a 6.8 percent increase in the index for
¶2006. However, some private analysts predict GDP growth as high as 8 percent for 2006. The monthly economic activity index is viewed as a reliable leading indicator of GDP.

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Commentary of the Week: "Doubts and Certainties about the Bilateral Agreement Signed with Brazil". By Felix Pena. [Note: Translated and used with permission of the author, from an article published February 8 in La Cronista Comercial. End Note.]
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¶12. The region needs a solid relationship between Argentina and Brazil. The Competitive Adaptation Mechanism (MAC) can contribute to this. But Mercosur

also needs to search for a mechanism with greater reach.

¶13. The bilateral agreement is a very long text with several parts open to interpretation.

¶14. In the current South American context, anything that helps strengthen relations between Argentina and Brazil is positive. The region's pace of evolution is accelerating.

¶15. In each country in the region, two simultaneous processes are being put to the test by contradictory, rending forces at the global level, both in the area of security as well as economic competition. One is the consolidation of strong and stable democracies. The other is the construction of modern economies, supported by social cohesion, technical progress and international competition. Both feed on each other, require a lot of coordination of social energy, and implicitly require recognition of the fact that politics and economics are closely linked in the real world. Argentina and Brazil -- especially together with Chile and Uruguay -- can play the roles of hard core democracies that contribute to the stability of the region.

¶16. An analysis of the question of safeguards (or "competitive adaptation") should be taken from this political perspective.

¶17. Technically, the new protocol implements the Agreement on Economic Complementarity - ACE 14 - reached in December 1990 in ALADI and that, in turn, is based on the still extant Treaty of Integration between Argentina and Brazil, signed in 1998. A legal basis is article 22 of ACE 14, in which both countries agreed to introduce corrective mechanisms for

potential disequilibria in the enjoyment of the benefits of the agreement. What was recently agreed, therefore, is something that was foreseen.

¶18. Will this new agreement contribute to strengthen the bilateral relationship, reducing the recurrent commercial disputes that almost always exist in a few sectors of production or, at least, neutralize the political tensions between the two countries created by these disputes?

¶19. It is premature to make predictions yet, and we won't gain much by being overly optimistic. Nevertheless, it is useful to note a few risks with the intent of preventing the creation of future problems that affect the quality of bilateral relations. At least three risk factors are evident from reading the text of the agreement.

¶20. The first is the result of the technical legislation used. It is a very extensive text that opens up several areas to interpretation problems and, therefore, to its peaceful application. A more austere text would have been better, following various precedents that exist on safeguards in trade agreements. Much will depend on the efficiency of the Monitoring Commission and of the willingness of the sectors involved to reach agreements. As a last resort, the agreement provides for technical arbitration by an Experts Group. Its decision will be obligatory and not subject to appeal. But the non-compliance of the parties with the decision, which is the suspension of the competitive adaptation mechanism, could be very costly in political terms, because it would require the "rejection of the agreement" (one assumes that this refers to rejecting the new protocol).

¶21. The second risk results from the fact that the

new agreement remains outside of the dispute resolution mechanism agreed in the Protocol of Olivos. Because it is not an instrument of Mercosur, a party cannot resort to that mechanism in the case of a controversy. Experience indicates that these controversies are frequent in any agreement on trade or regional integration. For example, the diversion of trade that originates from other preferential trade agreements could be a source of future controversies.

¶22. The third risk is that Mercosur has not been able to create a similar instrument. If it does create one, according to article 29, the new protocol will no longer be applicable. And if it doesn't create one? That could affect Mercosur and open the door to problems because trade relations between Argentina and Brazil will become excessively bilateralized. This would not be a problem except for the asymmetries of relative economic size and relative competitiveness between the two countries, which was precisely one of the reasons given for negotiating the new protocol. An excessive bilateralization does not appear to be convenient for Argentina.

¶23. We proposed a flexible architecture for Mercosur in an article written with Fabio Giambiagi that appeared in La Cronista on November 11, 2005. But we had imagined it being the result of a consensual process involving the other two partners and always within the parameters of the fundamental Treaty.

¶24. Given the sensibilities exhibited in recent times, both in Paraguay and Uruguay, it would seem advisable to proceed in this way as soon as possible, to substitute a similar Mercosur instrument for this new protocol. [Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.]

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